Market View
More than words

Coming into this week, the expectation was for central banks not to upset the apple cart. Liquidity dries up in December, so sending strong messages that could potentially rock markets are not high on central banks' to-do lists.

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The rally across bonds and equities that gained traction since the start of November has been rapid and significant. The rally broadened as inflation, labour and economic data all showed signs of cooling. Last week, the Job Openings and Labor Turnover Survey (JOLTS) data came in lower than expected for October, indicating businesses were less keen to take on more staff. Job openings fell to the lowest level in two-and-a-half years.[1] While the JOLTS report showed loosening labour market conditions, nonfarm payrolls indicated the labour market remains tight, as the unemployment rate unexpectedly declined to 3.7%. The consumer price index (CPI) data came in earlier this week, showing price pressures moderating to 3.1% year-over-year (YoY). More encouragingly, on a three-month annualised basis, CPI came in at 2.2%, although core inflation remains higher at 4% YoY. However, after stripping out the lagging shelter component from this measure, inflation is at 2.1% YoY. (For more on shelter, please read this here.)

According to the Atlanta Fed GDPNow GDP Forecast, US GDP for the fourth quarter is tracking around 1.25% annualised, representing a material slowing from the third quarter's blockbuster 5.2% growth.

Federal Reserve (Fed) Chairman, Jerome Powell, has previously been seen to be emulating revered Former Chair Paul Volcker, who famously fought soaring inflation in the 1980s. The stop/start monetary policy of the 1970s was largely seen as a failure, hence Powell's previous emphasis on keeping rates higher for longer.

Powell's shift to a more dovish stance this week therefore surprised markets. At the September meeting, the so-called dot plot indicated a further rate hike in December. However, November's softer economic, labour and inflation data meant that the hiking cycle is over. Ahead of the meeting, market participants expected the Fed dot plot to show two rate cuts in 2024, albeit from a lower base. But, as of Wednesday, the median expectation of Fed Governors increased to three rate cuts. All told, by year-end 2024, the Fed now sees rates being 0.50% lower than they envisaged in the third quarter. This would take interest rates to 4.5% by the end of next year.

The futures markets had already moved ahead of the Fed, pricing in 1% to 1.25% of rate cuts before the meeting. The change in language buoyed this momentum, with 1.5% of rate cuts now priced in. This pushed ten-year Treasury yields back to 4% for the first time since July.[2]

While the Fed pivoted, both the Bank of England (BoE) and the European Central Bank (ECB) remained more sanguine. The BoE has the longest uphill battle when it comes to reaching its inflation target, and ideally would like to see wages come down before it considers any rate cuts. The ECB meanwhile is more constructive on its growth outlook. However, there is no question that the Fed wields an enormous amount of influence as it is still seen as the world's central bank. This means the BoE and ECB's messaging often falls on deaf ears.

The Fed may not have loosened its policy yet, but by firmly putting rate cuts on the table for the first time this week, prompting extreme moves in the market, this week's announcement represented more than just words.

As this will be our last communication for the year, we would like to thank all of our readers and wish them a Merry Christmas and a Happy New Year.

[1] US Bureau of Labor Statistics

[2] Bloomberg

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